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Transcription of Shorthand Notes of Carol Gordon - Finance Committee, December 2, 1996

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Meeting began 10:00 A.M.

Mr. Barnes noted that there were two additions to the agenda.

Minutes approved.

III. B. Results of Operations - September

Abdelhak: Page 11 - results are very close to budget in many respects; slightly ahead in revenue; expenses below budget in several areas. We experienced a better quarter and better first six months. Many of the things we anticipated seeing later in the year at AGH are better. In addition, the strength of the position of hospitals in Philadelphia in the market place continues to pay off. Not as many distractions as last year. Optimistic that we will have a great year.

McConnell: Highight key numbers. Admissions through September are 2% ahead of budget; total actual 7½ % ahead of last year. Increase in business is what driving results to this point. Sent September statements out previously.

Barnes: As you look at Page 11, I want to talk about net income issue. Last year was toughest year in this corporation since World War II from bottom line. Quantitatively, earnings were unimpressive. Management has been working very hard; we have to get the earnings up in this corporation. There tends to be a casual atmosphere on this issue. We are $3 million in the first quarter. We have $26 million of depreciation and amortization which tends to make things look good. Balance sheet shows $8 million of long term debt. Regarding cash flow, this is the only cash we have to do everything. In an asset base such as we have, this is no money at all to keep the plant modern and to do new things. Profitability is exceedingly important because it is the only real cash flow we have to work with. The point of this is that, as a team, we have to work hard to get this profitability up. We should have reported $20 million of operating profit, not $3 million. Know we all understand this point, but I want to underscore this point again.

Abdelhak: Page 13 - You will see that cash has actually declined, and it is because we didn't expense a variety of things (see next page), acquisition of physician practices, equipment, and other things are assets that decline.

Neuwirth: How do assets decline?

Abdelhak: The point is, if we were making money, those assets should be going up.

McConnell: There is a detailed accounting issue, FASB 124. It is the opportunity to recognize gains in your portfolio and run it through your P&L. With the change in accounting, we are able to take those right actions and take them back to the balance sheet. These are adjustments to the statements. In the future, we will be able, on any portfolio, we can run the values up and down on the balance sheet rather than having a volatile P&L. We are making adjustments to bring it into conformance with proposed audit guidelines.

Neuwirth: What about receivables?

McConnell: We are at 88 days of revenue in receivables. Those numbers continue to drop. Nationally, there are increases in Accounts Receivable, and we have continued to make improvements in our system. However, that doesn't affect the generation of cash or the use of cash.

Abdelhak: A Trustee in another meeting focused on that issue (Page 11, prior year variance), looking at last year's revenue against this year's revenue, and there is a $20 million increase in Accounts Receivable. Obviously, that is a legitimate concern, which is continuously being monitored. There is also bad debt, which was broken out in a couple of other entities and one Trustee was complaining that the total free care or short pay was 2% or something like that. Yet the bad debts were 12%. Question was, where was the other 10% coming from? I would like to address that - we are continuously giving up on that infamous advance conversion that we got into and we have a lot of concern about when you clean up your receivables and how long do you keep them on the receivable end of things, and that issue is still lacking significantly. We should monitor our other income (talked about billing here - Medicaid and Medicare); there are practically millions of transactions that occur daily.

Barnes: Strategy was right - you had a standard set of operating systems. Implementation was terrible.

Abdelhak: We should have a 5% bottom line excluding AIHG and the University.

Barnes: Important that the Finance Committee be missionaries at this point, because I

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don't think it is a common view that we make money.

Abdelhak: It is the only means we have to pursue our end.

Abdelhak: For future meetings, let's keep two things reported on: Bad debts and Accounts Receivable - have them tracked every quarter so we don't have any questions.

Neuwirth: Asked about investment income.

McConnell: We have had good returns in the market this quarter, but this will not continue.

Abdelhak: That is part of the management of assets; Treasury people have done a good job.

Statements accepted.

III. C.

McConnell: By way of introduction, 2½ when we put current investment.....

CG Note: I missed some comments here.

McConnell: Talked about pension plan. Historically, AGH had a significantly over funded pension plan. Since 84, we have placed no cash in the pension plan. As we have acquired other organizations, we set up an AHERF pension plan structure. We now have all AHERF in one combined pension plan, and its funding approximates its liabilities. We looked at revising the policies. We have taken a look at the policies and taken a look at our business and have made some revisions to our investment policies. Revisions are minor, but they are important and will put us on the track to have slightly less risk in our portfolio.

Patejunas: We spent a lot of time reviewing policies. Will hit highlights. Referred to page 16 in booklet. In mid-94, the current policy was established. Worked with AHERF management to jointly review policies in view of current circumstances. Conclusion was that policies were in pretty good shape but with modest modification they could be improved. Page 17, pension investment policy. Policy allocation (referred to it), recommendation is to change allocation (reviewed it); overall impact is to reduce risk slightly, to enhance diversification. Rationale is primarily actuarial. Recommended policy is very typical. We are recommending move from more aggressive approach to typical. Talked about move of 10% to 15% allocation in foreign stocks. Foreign markets are much larger than United States. Average allocation going up all the time and, importantly, foreign stocks provide good diversification benefit. Talked about these benefits, etc. Page 18 shows the returns of certain indices over 15 years.

Page 19 talks about endowment policy - not much of a change here; moving foreign stock up again, same rationale. Page 20 shows the recommended policy illustrated. Shows dollar growth. Page 21 - funded depreciation. Original policy took into account several factors, including the practices of other hospitals as well as the likelihood of needing to draw down on these funds. Noted there have been some large cash flows.

Barnes: Any questions or comments?

Neuwirth: Questions. Looking at the proposed diversification into higher percentages in foreign trade securities, why does that necessarily give us more diversification? Don't we have sufficient diversification among the over 5,000 securities in the United States when the return is no lower than foreign owned securities, and isn't there a high risk just because we are dealing off shore?

Patejunas: There is enough diversification in the United States. Foreign allocation is to provide a smooth series of returns and to protect against the crash of 1987. Foreign market is an anchor for periods when the U.S. market is not the best to invest in. Real rationale is to make it smoother.

Neuwirth: If we do not need to use principal, I still don't understand.

McConnell: Talked about the flow of the pension fund, fluctuating widely - there is more predictability in what you need to contribute to pension fund.

Neuwirth: Another case relates to allocation to bonds.

McConnell: Allocation to bonds is another way to lower the risk. We are looking for ways to cut back on risk. Both allocation and foreign stock allocation is to reduce volatility.

McConnell: With the pension fund, you also have to make monthly distributions of cash. Talked about the pension fund years ago - and the ideas that Mr. Barnes suggested.

Nimick: Typical pension fund - the income is going to take current payments if you have a young work force. In talking about foreign stocks - are we talking about developing countries, or what?

Patejunas: We are talking about developed countries (Pages 95-98).

Abdelhak: I think you are really talking Europe, principally.

___?___ If that is the case, the figures for returns are exaggerated because these include Japan and the far east.

Abdelhak: What does the fund include? Does it include Japan, Far East, Australia?

McConnell: Yes, you have all countries.

Neuwirth: I expect that by investing off shore we increase risk.

Patejunas: Talked about the managers who manage the funds and the good returns they are getting.

Abdelhak: What is important is that we are not investing in countries that are generally unstable. Next time, let's devote a few minutes to how our managers have done in comparison to ( ).

___?___ In future, could we get Ennis Knupp's report at the same time we get the agenda?

Resolution approved.

III. D.

McConnell: Over the last several months, Mike has been working toward consolidating the various lines of credit that Allegheny operating entities have throughout the system. This is a resolution authorizing AHERF to enter into this agreement. We have $83 million worth of lines of credit open with various banks. They all have different administrative covenants, different reporting, and different costs. By consolidating, we estimate we can save 70 basis points on the borrowing, which is about $400,000 - $500,000 per year. What we are attempting to do is set up AHERF as a manager of this line of credit. Any borrowings would be directed to the operating units' credit. Each operating unit would need to sign a note with AHERF, which would then be passed on to the lender. We have negotiated good terms. Mike has bid this with all of the banks in town. PNC has done a good job in the past. For this process, Mellon has come forward with the best opportunity. This is a good time to establish a relationship with Mellon. There is still enough business in the organization for PNC. Not asking for a higher line.

Moved.

Neuwirth: Will PNC still retain some of our business?

McConnell: Yes.

Martin: From a lending perspective, that is the majority of our business; gave that exposure to us on some letters of credit on outstanding debt and some other term loans. This brings Mellon up to a more serious level. They will have about $35 million of exposure.

McConnell: We are going to try to work with Mellon to see who they lay this exposure off on. Just asking authorization to enter into the lines of credit.

Abdelhak: As a mater of policy, we try to deal with all of the major banks and, in fact, we have been trying to find something to do with Mellon.

Barnes: PNC has been very good to us and we are appreciative of all they have done for the organization and will make sure they are well taken care of and we expect them to be important in the future.

Approved.

IV. A.

Martin: Will turn this over to Doug. As we have in the past, we typically have Ennis Knupp to review this and give us the grand picture.

Patejunas: Page 8 in grey book: For each of the major fund groups, we have a year to date number which is recent performance. Page 8 - talked about returns; compared to benchmarks. Turned to page 9, Page 10 - returns of the endowments broken into three groups: Pittsburgh based AGH, MCP, SCHC. Table here uses investment pool in front of MCP, SCHC. Monies have been pooled recently. Page 11 shows AHERF short term assets. Page 12 - insurance related assets. Page 13 summarize - recapping year to date results for all funds. Only two are behind their benchmarks. All others are ahead.

McConnell: Pleased with the guidance Doug Patejunas has given us. No other questions.

Neuwirth: Thank you for the grey book.

IV. B.

Martin: Informational piece on AHERF charity care endowment. Page 30 begins the information. Information lays out value of this fund over the period of the past

three fiscal years and includes information for Fiscal Year 97 to date. Fund has grown substantially over time period as a result of funds flowing into endowment. Talked about some results. We have estimated income will be about $240,000 for Fiscal Year 97.

Barnes: Why can't it be under the master trust of another account?

Martin: It will ultimately be with another manager. For now, we are staying with Mellon; their returns have been good. Since inception of this endowment, there have been no requests from any AHERF operating entity for distributions out of this fund which reflects our goal of allowing this fund to grow. Operating units are funding these costs.

IV. C.

Martin: We wanted to present to you data about our bond remarketing experience to date. There are two Obligated Groups within the organization - it is the debt that is linked to the AGH Obligated Group and the Delaware Valley obligated Group. They are separate credits. The recent transaction earlier this year consolidated all of their debt into a single credit. We have in the past utilized the variable market. What we get out of this program is access to lower interest rates. The hedge in this program is that we maintain a mix between variable rate and their fixed rate debt. Other point is technical. This paper is backed by letters of credit issued by banks. So it trades not only on our organization but on the bank who issues the letter of credit. See page 34 - compares our experience for AGH Obligated Group; it is remarketed every seven days. Talked about rates we are getting with comparisons in book. Page 35 is a summary information which shows the Pittsburgh Obligated Group has experienced returns under 4% for this kind of paper. No information for Delaware Valley, since that information is relatively new.

Abdelhak: Can we report on this to some of the other boards? There was concern at AGH in terms of the variable debt. I think they may need to see the results. Could also report to the Delaware Valley.

McConnell: We should take it to the other operating units. Wanted committee to see that on an independent basis, we are doing okay.

IV. D.

McConnell: Mentioned this earlier but will summarize. At the Audit Committee meeting, we reviewed audited statements for the system and were concerned about ( ) which required us to adjust our bottom line for the portfolios. This could put us at serious risk should the market swing at the wrong time. There is a new audit

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guide which speaks to eliminating this volatility. The audit guide now affects only health care but not universities. Risk is minimized here. Had one-time benefit last year.

Abdelhak: Have you made a decision?

McConnell: Guidelines are proposed. We expect them to become final. We don't really want anything else.

Barnes: Think this is a great step forward.

IV. E.

McConnell: This is here for your review. Audit Committee suggested that we do it with each operating unit.

Neuwirth: Have a question on something else. Looking here seeing the costs of payments for health insurance premiums. What is the potential for us to self-insure?

Abdelhak: Disastrous. We tried it and can't do it. Two years ago, I directed that we buy insurance and we did see a dramatic drop in our costs.

Kasperbauer: It is a competitive market, and this is our best way.

Abdelhak: When it is managed by someone else.

IV. F.

____?____ Investment we have made in AIHG, and is there an opportunity for us to get some of that investment back?

Abdelhak: Talked about whether we can maintain the control that we want but nonetheless find something that is marketable in the management of it. At my request, David has made some inquiries, and we will be starting to talk to those people and you will help us and then you can report on it to this committee.

____?____ Anything else?

Meeting adjourned 11:20 a.m.

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EXHIBIT 13

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Transcription of Shorthand Notes of Carol Gordon - Finance Committee, March 14, 1997

NOTE from transcriptionist:

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12:07 p.m.

No additions.

Minutes approved.

III B. Results of Operations

Abdelhak: As far as activity is concerned and net revenue, we are significantly ahead of last year and somewhat ahead of budget. In Pittsburgh, AGH has seen a tremendous increase in activity and market share has gone up by 12%. In the Delaware Valley, the consolidated group have seen a moderate increase in some hospitals that were offset by moderate decline; however, market share is up. Very competitive in the marketplace. Revenues are up. Costs are also up at rates that are slightly faster than our revenues, principally in the area of supplies and services. We continue to try to analyze that to see if we can effect additional economies. Anticipate we will be able to do so. Expect to achieve our year end budget result. When you look on the CPAD basis, adjusting for acuity, most of these institutions are doing better than budget. St. Christopher's is in a unique position for the first time; they will break even for the first six months. They had an incredible January and made up an enormous amount in January and regrettably their services are seasonal. We are encouraged by our market share and our total activity being up. Expect we will make progress by the end of the fiscal year.

McConnell: Page 13 summarizes the six month consolidated profitability page. What you will see is the result of the increased volume that Sherif has addressed. Running about 1% ahead on a discharge basis. This is significant growth. Seeing like increases in operating revenue. Overall revenue for the six month period is $19.4 million ahead of budget. $27 million favorable investment income. Research and training and minor negative revenue variances are spread throughout organization. There is $90 million more of revenue than we had for the first six months last year.

Significant increase in revenue as a result of growth in volume. $1.7 million, 14+ ahead of budget. Slightly behind last year for the six month period.

Page 16, balance sheet - none of the numbers include Forbes (January 1), Allegheny Valley (March 1), or Graduate entities. This is AHERF as it was last year. Two items noted: Cash noted remains virtually the same over the six month period. Increase in Accounts Receivable but days in Accounts Receivable are down one or two but total dollars grows as business grows. Claims are up. Funded depreciation has decreased by $46 million; funds have been spent to finance the capital acquisition in the organization. Not many other major variances. Additional external funds for research is important, and it is going up. Balance sheet key indicators tend to be the same as six months ago. Any questions?

Abdelhak: Our challenges here are AIHG, and I can assure you because I am confident that every effort is going into making adjustments that will reduce the level of ( ) and the University which has been subjected to arbitrary action as well as professional fears are concerned. Most payers are making adjustments to the professional fees downward without notification. Professional fees have lagged as a result and, of course, our costs do not disappear. We are working here to try to close the gap within the University. This gap is small by all measures. Our principal challenge is AIHG. Just as a matter of policy, it is my inclination that we do very limited additional fixed equipment. That we use the contracting methodology and can get all the benefits we wish without additional financial outlay. That is not to say we will not acquire any practices, but we will not acquire them at the same rate. There will be selected acquisition providing approximately 25% of the capital we expended each year. That will give you some sense of stabilizing it. There is a potential for two big blocks of acquisitions again that are connected with healthcare plans - one that has roughly 250,000 members and one has 50,000 members. We have initiated discussions on both of them. Talked about acquisitions of health care plans. Usually health plans want to give you their physicians along with the members. That is an important consideration; it was part of the audit plan discussion and that is the oversight of the risk contract; my estimate is that by year end we will have close to 900,000 lives at risk for fiscal year end. Anticipate that by the end of 1998 we will have 1½ million people that we are responsible for all their health care across the system. With this comes the challenges mentioned earlier. This will certainly have effect on next year's results.

Barnes: Any questions? No.

Barnes: Page 19 - Looking at patient days, that seems to be a major problem - people spending less time in the hospitals.

Abdelhak: There is some work that would not be contemplated as ambulatory work and over the next 18 months it will be. Each time you move something out, it has a great effect. We are in the process of wrapping up someone in Philadelphia and he is close to making that an outpatient surgery (1200 knees/year). Technology has cost them more than managed care driven. Question is what was the length of stay of the knee anyway? Think there will continue to be movement as technology improves.

Barnes: Mentioned hospital utilization.

Abdelhak: Think there will be a breakdown and we want to make sure none of our facilities is part of that breakdown.

Resolution approved.

II C. Budget Guidelines

Abdelhak: These are the guidelines I gave to all of the entities. Basically, there are a few changes; modifications to account for some of the recapture in the second bullet. That is, Forbes net income will be in excess of 12% as a result of the depreciation recapture. Expect University to break even. AIHG expected to yield 25% improvement on a practice basis. At the AHERF entity, all of the investment earnings will go to the bottom line. We have suggested that 20% of the remaining assets will be provided to AHERF to support system growth. For the most part, we have been using that to take care of the Information Systems installation which will have huge benefits to the operating units. Remaining cash to operating system. I have reduced capital to some operating units and you will see Pages 29, 30 some of the anticipated results for 1997 and then the projection for 1998. Calculation on Page 30. Please understand that this is after we properly provide the University from the hospitals with support totaling in excess of $100 million. Support for the research and education mission. Page 31 is another. Results of capital budget is in the right hand column.

Barnes: Critical issue is to achieve these numbers. Very important to get our achievements up. Asked about Information Systems. What is status?

Dionisio: The Information Systems roll out - The clinical phase and academic phase is a three-year project leading up to the Lifetime Clinical Record. We are about six

months into this project. About four weeks behind, not critical. Expenditures on budget. Mary Anne Darragh, David, and I met with Sherif to keep him apprised of the status of the individual applications.

McConnell: We have committed to give an annual report to the Committee.

Abdelhak: I gave them three goals: Eliminate paper, eliminate film, and reduce our principal costs of producing a unit of service so that it is 60% of our competitors. At this stage of technology development, I know we will get the first two but will not achieve the third one for a while. Until then, those of us who are dinosaurs and refuse to use computers are a major stumbling block until voice recognition technology catches up. We will have a voice transcribing service by phone, and it will be entered into the system. We typically do that by exception. My disappointment is that voice recognition system to date is not likely to be available when this is complete in another 30 months, and we will not achieve the third goal for a while.

Snyder: How do we bring people up to date?

Dionisio: We are bringing people up to date educationally. That will lie with the University that will begin to educate all of our employees who are not computer literate.

Abdelhak: Estimate we will need 440,000 hours of instruction to fully utilize the capabilities.

Neuwirth: Could I get some feel on the new entities that are being folded in? Page 29, 30. Some discussion on background as to how secure you feel about the targets for 1998 concerning Graduate, City Avenue, and Parkview.

Abdelhak: I feel fairly confident with these numbers so we gave you the low end of everything.

Approved.

IV. A.

McConnell: Mike will present the highlights.

Martin: In terms of introductory remarks, two major points: Have been talking about restructuring the investment management for the organization, and we added more challenges to the queue with the addition of affiliates. Continue to work on consolidation of assets and reporting of the assets. We are well on our way of

achieving our target of saving $300,000 per year for managing the assets. We will be at about $200,000 to lower our costs. At the last meeting of the Finance Committee, we reviewed investment policies for each fund in the organization. Approved recommendation to reduce some allocations to domestic stocks, etc., and those changes have been effected and are reflected in any performance numbers after January 1.

Martin: Direct your attention to page 38 and can get a sense of how assets are allocated across organization. As of December 31, the organization has close to $713 million of assets that are invested and that excludes any assets within Forbes, Allegheny Valley, and Graduate organizations. It is my expectation that putting their assets in would get us close to $900 million. Page 38, you can see that by entity, AHERF holds the largest amount of assets that consists primarily of endowments and they continue to represent the largest portion of the overall portfolio. In terms of the type of exposure that we have within the organization, the allocation to equity or equity type investments resides at 50% level.

Martin: Page 39, 40. Review performance we have experienced. Pension Master Trust review returns, net of fees. Page 40, reviewed these funds.

Gumberg: Page 37- small investment in Equitable Prime Fund - recommend we get out if there is an opportunity. Prime strategy was employed 20 years ago and they are defending a small region of shopping malls that might not be in existence next year.

Martin: Agree; Real Estate arm is up for sale. We would like to take that as an opportunity to seriously consider getting out of this exposure.

Barnes: Good point, Ira.

IV. B.

McConnell: Accounts Receivable throughout the organization is an issue management is spending much time focusing on. We have sent you a large report, detailed presentation prior to the meeting. Joe will comment on additional improvements since the report was sent out.

Dionisio: What we attempted to do in the report provided to you was to tell you where we were. This consolidation started in 1994. Was completed June, 1995, and since that time, Pittsburgh has been responsible for all billing and collection activities. Faced challenges; worst behind us. Believe our current results measured by

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amount of cash in comparison to net revenue suggest to us that we have turned the corner. Results: provide him daily with cash reports, collections, and each month it essentially sets a record in comparison to previous results. With emphasis placed on the back end over the last year-and-a-half, we wish we could have addressed front end on interdependencies and most focus will be devoted to those interdependencies.

Barnes: Two final issues in the corporation: (1) Quality clinical service, and (2) Getting paid for it - getting more complex at the same time the insurers are developing.

Barnes: Hope you have seen the report. Talked about the desirability of visiting the receivables shop that we have in Pittsburgh. We will try to get that done. Thought we would like to see it but high on our agenda is to have a visit with the receivables shop because it is one of the key things in the corporation today.

Abdelhak: I think earlier in the Audit Committee when David reported on how large the pool of funds are that are assigned self-pay, I encouraged the Audit Committee to take under advisement of recommending to the Board that we institute the practice of asking for a credit card from an individual who is determined to be self-pay so that we have an imprint of a credit card charge and have hope of collecting some of the funds. It would be limited to elective admissions (not Emergency Room), and we should consider that action. I can assure you that we have thought about it in management for a while and decided that what we need is some consultation with our Trustees so that you can help us make a judgment and want to come across as a compassionate provider and not a money hungry institution.

Gumberg: Observation - compliment the report; it was very complete. Compliment management on the presentation. Noted the efficiencies.

Barnes: Agree, it was a good report.

Neuwirth: Given the enormity of the dollars involved, I think management should be very complimented and echo Ira's remarks. Knowing each day that we could bring receivables down we could put the money into use for us. David, I think it would be appropriate to ask for an update on this report in six months to see which efficiencies and improvements are starting to pay off.

Abdelhak: David will prepare a quarterly update, and we will try to summarize some of these expanded reports.

IV. C.

McConnell: Last year the FASB put out Announcement #124, which gave us a tremendous amount of concern. It said the investment portfolio gains or losses would need to be reflected in your monthly P & L. This gave us a level of volatility that was unacceptable. Committee wondered about what this may do to an organization over time. Changes were made, and we can take gains or losses. We do not have this problem this year.

IV. D.

McConnell: Here for your review. Same comment. Any questions?

Adjourned, 1:00 p.m.

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Transcription date: 3-22-01

EXHIBIT 14

Finance Cte 6/20/97

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